

MEMORANDUM

April 27, 2012

TO: County Council

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Office of Legislative Oversight

SUBJECT: **OPEB Funding Status and FY13 Agency Budget Requests**

This memorandum responds to the Council's request for an updated review and analysis of Other Post-Employment Benefits (OPEB) funding for the tax-supported agencies: Montgomery County Government, Montgomery County Public Schools (MCPS), Montgomery College, and the Maryland-National Capital Park and Planning Commission (M-NCPPC).

Section I. Introduction provides an overview of OPEB funding approaches and provides data on OPEB liabilities and assets for each agency.

Section II. FY13 OPEB Budget Requests summarizes FY13 agency OPEB funding requests.

Section III. OPEB Pre-funding presents the advantages and disadvantage of OPEB pre-funding, and discusses the relationship between OPEB pre-funding and government bond ratings.

Section IV. Supplemental Information provides background information and context for the Council's FY13 OPEB funding decisions, including past OPEB policy and governance history.

I. Introduction

Other Post-Employment Benefits (OPEB) are non-pension benefits offered by an employer to qualified retirees. Employer OPEB obligations primarily consist of retiree health care benefits, but may include other benefits such as life insurance. In Montgomery County, each agency sets OPEB benefit levels and eligibility criteria for its own retirees. The agencies currently fund OPEB benefits through a dual approach summarized below.

- **OPEB pay-as-you-go funding** refers to the annual cost of group insurance benefits for current retirees. Under the pay-as-you-go funding method, agencies annually budget resources to pay the current year's cost of health care claims for retired employees and their dependents.
- **OPEB pre-funding** is a practice of setting aside assets at the time employees earn a benefit to cover cost obligations that will be paid in the future. Most governments (including all County agencies) pre-fund their pension benefits. Agencies that pre-fund OPEB benefits often make contributions into a trust fund designated for retiree health benefits. **Last year, the Council established a consolidated OPEB trust fund for the County Government, MCPS, and Montgomery College.** The bi-County M-NCPPC manages its own OPEB trust fund.

Agency OPEB Liabilities, Assets, and Required Contributions. An agency's OPEB liability refers to the present value of benefits earned to date for employees' past service. The value of OPEB assets refers to the current value of cash or investments placed into a fund to pay future liabilities. The annual required contribution is how much an agency must contribute each year to reach full OPEB funding (pay-as-you-go and pre-funding portions) within 30 years.

Table 1 below shows each agency's actuarially determined OPEB liability and annual required contribution from the County Government's most recent Multi-Agency OPEB Fiscal Update. These are the data used to develop the County Executive's FY13 OPEB budget recommendations, and are based on OPEB actuarial valuations as of 6/30/2010. In sum:

- As of FY11, the total estimated OPEB liability for County Government, MCPS, Montgomery College, and M-NCPPC is about \$3.3 billion.
- The actuarial value of OPEB assets in the agency trust funds, \$98.6 million, represents 3.0% of the nearly \$3.3 billion of OPEB liability. This calculation is known as the "funded ratio."
- The agencies' OPEB annual required contribution (including both pay-as-you-go and pre-funding amounts) totals \$296.8 million.

Table 1. Agency OPEB Liabilities, Assets, and Annual Required Contribution
(based on actuarial valuations as of June 30, 2010)¹

Agency	Actuarial Accrued Liability	Actuarial Value of Assets	Funded Ratio	Annual Required Contribution
County Government	\$1,737.4 million	\$38.2 million	2.2%	\$147.6 million
MCPS	\$1,361.0 million	\$34.6 million	2.5%	\$131.7 million
M-NCPPC ²	\$128.7 million	\$3.8 million	2.9%	\$11.8 million
Montgomery College ³	\$69.1 million	\$22.0 million	31.8%	\$5.7 million
Total	\$3,296.1 million	\$98.6 million	3.0%	\$296.8 million

Sources: Montgomery County Department of Finance FY11 OEPB Fiscal Update, Agency OPEB Valuations, and FY11 Comprehensive Annual Financial Statements

Pre-funding Phase-In Policy. In May 2008, the Council approved Resolution 16-555 stating its intent to phase-in OPEB pre-funding⁴ over an eight-year period from FY08 through FY15. The plan called for the County to fund one-eighth of the actuarially required pre-funding amount in the first year (FY08), two-eighths in the second year (FY09), and so on, until FY15 when the County would make 100% of the actuarially required OPEB contribution. To adhere to the policy, the County would have to make a contribution equal to six-eighths (75%) of the annual required contribution in FY13.

¹ M-NCPPC and Montgomery College have updated OPEB valuation data as of June 30, 2011; however the County Government's most recent Multi-Agency OPEB Fiscal Update utilizes data as of June 30, 2010 for all agencies.

² M-NCPPC valuation includes Montgomery County and Prince George's County employees/costs. Montgomery County's OPEB funding schedule assumes that the Montgomery County portion is 45% of the total plan.

³ For several years prior to FY08, the College had set aside funds for accrued retiree health liabilities. These resources (~\$20 million) were placed the College's OPEB Trust Fund in FY08, accounting for their comparatively high funded ratio.

⁴ Council Resolution 16-555 defined OPEB pre-funding as "the difference between the OPEB pay-as-you-go contributions and the Annual Required Contribution."

II. FY13 OPEB Budget Requests

As part of its annual operating budget decisions, the Council considers funding levels both for OPEB pay-as-you-go and pre-funding.

A. FY13 Recommended OPEB Pay-As-You-Go Funding

The agencies' FY13 recommended budgets include funding to cover the employers' portion of annual retiree health insurance premiums. As shown in Table 2, the four County-funded agencies recommend budgeting a total of \$88.3 million in FY13 for retiree health pay-as-you-go funding.

Table 2: FY12 Approved and FY13 Recommended Retiree Health Pay-As-You-Go Funding by Agency

Agency	FY12 Approved	FY13 Recommended	Percent Change FY12-13
County Government	\$32.5 million	\$32.5 million	0.0%
MCPS	\$48.1 million	\$49.3 million	+2.4%
Montgomery College	\$3.2 million	\$3.2 million	0.0%
M-NCPPC	\$2.7 million	\$3.4 million	+26.8%
Total	\$86.4 million	\$88.3 million	+2.2%

The County Government, MCPS, and Montgomery College anticipate little or no increases in retiree health pay-as-you-go contributions from FY12 to FY13. The stability in pay-as-you-go funding for these agencies is a result of lower than anticipated claims costs as well as the availability of surplus reserves in retiree health benefit funds.

In contrast, M-NCPPC will experience a large increase in its retiree health pay-as you-go cost. M-NCPPC's proposed FY13 Budget notes that the health insurance rates charged to departments and employees/retirees were held constant for the past five years as excess reserves were used to offset rate increases. However, in FY12 M-NCPPC adjusted all health insurance rates to reflect market value and projects 12-15% cost increases for medical and prescription plans in 2013.⁵ M-NCPPC quantified the impact of the rate adjustments on retiree pay-as-you-go costs as follows:

Based on market trend and the need for the Commission to increase its health insurance rates, which have not been increased in five years, the pay go cost will be increasing Commission-wide from \$6.6 million to \$8.3 million. The amount apportioned to Montgomery departments will be increasing from \$2.65 million to \$3.36 million in FY13.

⁵ M-NCPPC Montgomery County Proposed FY13 Budget, pg. 247.

B. FY13 Recommended OPEB Pre-funding

The OPEB pre-funding budget is the amount the County plans to contribute into trust funds in FY13 to cover already incurred future costs of retiree health benefits.

Table 3: FY12 Approved and FY13 Recommended OPEB Pre-Funding by Agency

	FY12 Approved	FY13 Recommended	Percent Change FY12-13
Tax Supported			
County Government	\$26.1 million	\$43.6 million	+ 69.7%
MCPS	\$20.0 million	\$61.9 million	+ 209.7%
Montgomery College	\$1.0 million	\$1.9 million	+ 87.3%
M-NCPPC ⁶	\$2.6 million	\$3.4 million	+ 35.0%
Total Tax Supported	\$49.6 million	\$110.7 million	+ 123.2%
Total Non-Tax Supported ⁷	\$12.2 million	\$11.6 million	- 4.9%

Note: Tax supported agency values may not sum to the total due to rounding.

As shown in Table 3, **the Executive recommends \$110.7 million in tax-supported OPEB pre-funding for FY13; this is more than double the amount approved for FY12.** As noted above, the Council approved a policy to ramp up OPEB pre-funding over an eight-year phase-in schedule. According to this policy, the County would contribute \$128.9 million or 75% of the actuarially required OPEB pre-funding amount in FY13. **The Executive's FY13 tax-supported OPEB pre-funding recommendation is 64% percent of the actuarially required amount or \$18.2 million less than called for under the pre-funding policy.**

The Executive's recommended FY13 operating budget book includes a six-year fiscal plan. As shown in the table below, the fiscal plan assumes that the County will increase its tax supported OPEB pre-funding to 83% of the actuarially required contribution in FY14 (which would be slightly below the 87.5% funding level called for under the pre-funding policy for FY14). The fiscal plan assumes that the County will fund 100% of the actuarially required contribution in FY15 and beyond, consistent with the pre-funding policy.

Table 4: FY13-18 Tax Supported OPEB Pre-Funding – All Agencies Combined from Executive's Recommended Fiscal Plan

	FY13	FY14	FY15	FY16	FY17	FY18
\$ Amount	\$110.7 million	\$142.8 million	\$171.9 million	\$171.9 million	\$171.9 million	\$171.9 million
% of Required Contribution	64%	83%	100%	100%	100%	100%

Additional information about the County's OPEB legislative and policy history appears on page 7.

⁶ The M-NCPPC pre-funding amount represents the Montgomery County portion of the bi-County agency's contribution.

⁷ The FY13 non-tax supported OPEB pre-funding recommendation includes \$11.41 million in County Government proprietary fund and participating agency contributions and \$0.14 million in M-NCPPC proprietary fund contributions.

III. OPEB Pre-funding

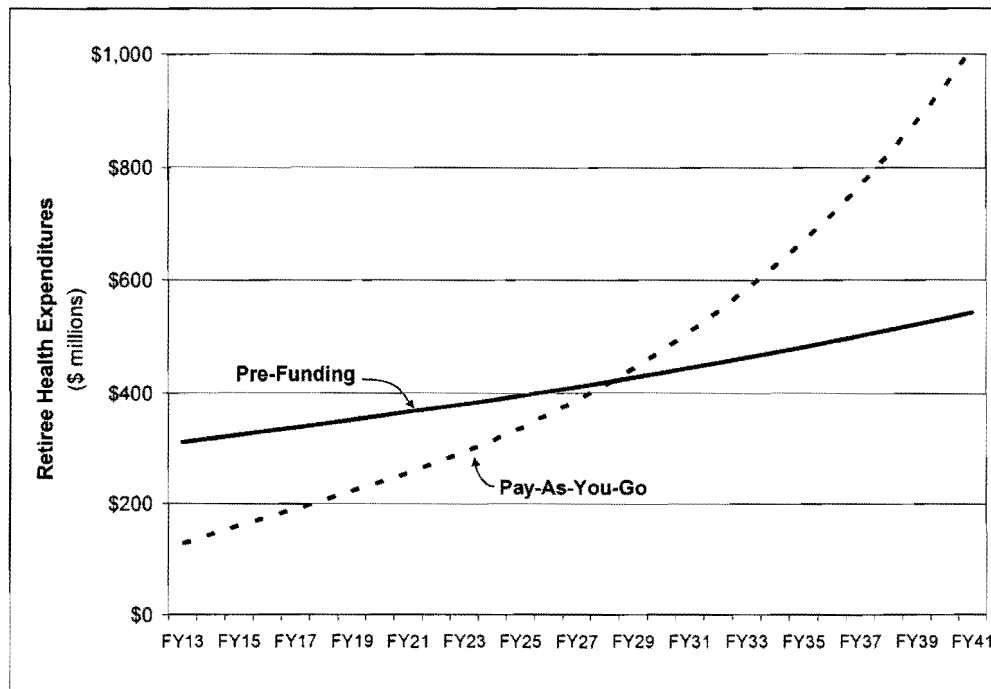
This section presents the advantages and disadvantage of OPEB pre-funding and discusses the relationship between OPEB pre-funding and government bond ratings.

A. Advantages and Disadvantages of OPEB Pre-Funding

Pre-funding retiree health benefit costs has several advantages over paying solely on a pay-as-you-go basis:

- Pre-funding OPEB obligations requires fewer tax dollars over the long-term than the pay-as-you-go method because the investment of trust fund assets earns income that later can be used to pay for retiree health costs.
- With pre-funding, an employer pays the estimated costs for retiree health benefits as they are incurred instead of deferring costs for future taxpayers to pay.
- Setting aside resources at the time employees accrue future benefits ensures that more resources will be available to fund the benefit.
- As life expectancy increases and health care costs continue to rise, governments are likely to face rapidly escalating OPEB costs. As shown in the graph below, pre-funding smoothes the long-term OPEB cost curve which stabilizes the annual rates of growth (as compared to pay-as-you-go).

**Projected Combined Retiree Health Costs for County-Funded Agencies
Pay-As-You-Go versus Pre-Funding⁸**



⁸ Projected pre-funding costs assume payment of full annual required contributions for all agencies with an annual 2% increase for actuarial adjustments. Projected pay-as-you-go costs assume health care inflation rates included in the latest County Government OPEB valuation and an annual 2% increase for actuarial adjustments.

The disadvantage of pre-funding is evident in the context of the annual budgeting process. Until a government has built up its OPEB trust fund, pre-funding will demand significantly greater resources than pay-as-you-go. The competition for finite government resources often makes pre-funding difficult, particularly in years when resources are scarce and demand for public services are high.

B. OPEB Pre-Funding and Bond Ratings

When evaluating the credit-worthiness of governments, bond rating agencies take into account multiple fiscal factors including a jurisdiction's OPEB liability. Rating agencies regard OPEB unfunded liability (the amount that the current liability exceeds current assets that are set-aside exclusively for OPEB) as an obligation similar to long-term debt. As with long-term debt, OPEB unfunded liability is an obligation that reduces the amount of future government resources that are available for programs and services.

In assessing the risk of government borrowing, rating agencies consider the budgetary impact of future year OPEB costs as well as the government's plan to manage these costs. As stated on the County Department of Finance's web site:

In a fiscal sense, commitments to pay out benefits to retirees compete with commitments to pay debt service on bonds, so the rating agencies have an obligation to report to the County's investors how well prepared the County is to meet all of its future commitments... Montgomery County currently has an AAA Bond rating, which is the highest rating given to public entities. But if the County is not found to be satisfactorily addressing its liabilities, this could impact the County's rating.⁹

There are no precise standards to inform a government what level of OPEB pre-funding is necessary to avert a rating downgrade. Nonetheless, rating agencies have guidelines describing how they assess OPEB risk. For example, Standard & Poor's assesses State government OPEB risk on a scale from one (low risk) to four (high risk) as shown in the table below.

Risk Level	OPEB Risk Assessment
Low (1)	Limited benefits provided or benefit consists of allowing some participation in the health plan (cost paid entirely by the retiree, implicit subsidy recorded), high level of discretion to change benefits, pay-go costs are not significantly different from the actuarial required contribution.
Moderate (2)	Moderate/average liability relative to other states, proactive management of the liability in our view, some flexibility to adjust benefit levels, contributions in excess of the annual pay-go amount have been made in order to accumulate assets to address the liability.
Elevated (3)	Above-average liability relative to other states, options to address the liability are being considered but plans are not well-developed in our view, there may be some flexibility to adjust benefits but changes have been limited.
High (4)	High liability relative to other states, high level of benefits that are viewed as inflexible based on statute/constitution/contract terms, a lack of management action to address the liability in our view which will lead to accelerating pay-go contributions.
Standard & Poor's RatingsDirect on the Global Credit Portal, "U.S. State Ratings Methodology," January 3, 2011. Reproduced with permission of Standard & Poor's Financial Services LLC. See full disclaimer on ©1.	

⁹ http://www.montgomerycountymd.gov/mcgtmpl.asp?url=/content/finance/opeb_faqs.asp#q2

As evident in the Standard & Poor's risk assessment guidelines, rating agencies take into account OPEB management decisions and pay-as-you-go cost trends when evaluating a government's credit-worthiness. Bond rating agencies assign the lowest risk to governments that take management action to control the growth of retiree health pay-as-you-go costs.

Recent events show that growth in unfunded OPEB liability can contribute to a bond rating downgrade. For example, in January 2012, Moody's Investors Service downgraded the general obligation bond rating for the State of Connecticut. In describing the rationale for the downgrade, Moody's attributed the action to "Connecticut's high combined fixed costs for debt service and post employment benefits relative to the State's budget."¹⁰

II. Supplemental Information

This section provides OPEB background information and context for the Council's FY13 OPEB budget decisions, including:

- County OPEB legislative, policy, and governance history;
- FY08-FY12 OPEB funding levels;
- Agency OPEB assumptions;
- GASB reporting requirements; and
- Strategies to decrease future OPEB liability.

A. County OPEB Legislative, Policy and Governance History

In 2003, after the GASB released preliminary drafts of the OPEB reporting rules, County agencies as well as the Council's Management and Fiscal Policy (MFP) Committee began working to address the new requirements. The key OPEB-related legislative, governance, and funding events that followed are summarized below.

- **Multi-agency updates.** In November 2005, the MFP Committee held the first of a regular series of multi-agency updates on the OPEB requirements and their implications for County agencies.
- **OPEB workgroup.** In 2006, a multi-agency OPEB workgroup was formed with County Government, MCPS, Montgomery College, M-NCPPC, and WSSC representatives.
- **Adoption of five year pre-funding phase-in policy.** In April 2007, the Council adopted resolution 16-87 stating the Council's policy intent to fund the difference between the OPEB pay-as-you-go contributions and the annual required contribution over a five-year period beginning with FY08 for the tax supported agencies. For the bi-county agencies, the resolution stated the Council's policy intent to support WSSC's and M-NCPPC's plans to implement a similar five-year phase-in schedule.
- **Establishment of OPEB Trusts.** Each agency established an OPEB Trust prior to or during FY08, and began depositing OPEB pre-funding appropriations into their respective trusts. For County Government, the Council adopted Expedited Bill 28-07 to formally establish a Retiree Health Benefit Trust in the County Code.

¹⁰ Moody's Investors Services http://www.moody.com/research/MOODYS-DOWNGRADES-STATE-OF-CONNECTICUT-GENERAL-OBLIGATION-BONDS-TO-Aa3--PR_235771, January 20, 2012.

- **Adoption of revised eight-year pre-funding phase-in schedule.** The County Executive's FY09 Recommended Operating Budget proposed switching from the five-year phase-in schedule to an eight-year OPEB pre-funding schedule due to the County's fiscal situation. In May 2008, the Council adopted Resolution 16-555 that amended the prior OPEB pre-funding resolution and established an eight-year funding schedule.¹¹ The Council appropriated OPEB pre-funding dollars in FY09 based on the new eight-year schedule.
- **Fiscal constraints eliminate OPEB pre-funding for FY10 and FY11.** Due to fiscal constraints, the Council did not appropriate any tax supported OPEB pre-funding dollars to any agency in FY10 or FY11.¹²
- **Creation of consolidated OPEB Trust and resumption of pre-funding in FY12.** In June 2011, the Council adopted Bill 17-11 to amend the Retiree Health Benefit Trust to allow the Trust to receive OPEB pre-funding for MCPS and Montgomery College in addition to County Government.

OPEB pre-funding is addresses in two additional policy statements.

Charter Mandated Fiscal Policy. Section 302 of County Charter states that "the County Executive shall submit to the Council, not later than March 15 of each year, comprehensive six-year programs for public services and fiscal policy" (emphasis added). The Executive's recommended operating budget document annually includes a fiscal policy chapter.¹³ In every year since FY09, the fiscal policy chapter included the following statement regarding pre-funding of retiree health benefits:

The County also intends to phase in to full pre-funding of its Annual Required Contribution (ARC), from the current pay-as-you-go approach, beginning with contributions to one or more trust funds established for that purpose, over an eight-year period beginning with FY08.

Council Reserve and Fiscal Policies Resolution. In FY11 and FY12, the Council approved a "Reserve and Selected Fiscal Policies" resolution. These resolutions included a policy statement that identified payment of OPEB unfunded liabilities as a priority use for one-time revenues.

If the County determines that reserves have been fully funded, then one-time revenues should be applied to nonrecurring expenditures which are one-time in nature, pay-as-you-go for the CIP in excess of the County's targeted goal, or to unfunded liabilities. Priority consideration should be given to unfunded liabilities for Retiree Health Benefits (OPEB) and Pension Benefits Prefunding.¹⁴

¹¹ Council Resolution 16-555 defines OPEB pre-funding as "the difference between the OPEB pay-as-you-go contributions and the Annual Required Contribution."

¹² For FY10, the Council approved \$12 million in OPEB pre-funding for MCPS. With the mutual consent of the Council and the Board of Education, MCPS expended the \$12 million for other budget priorities.

¹³ The Council annually approves agency operating budgets and the County's fiscal plan. To date, Council budget resolutions have not included approval of the text of the fiscal policy included in the Executive's recommended operating budget document.

¹⁴ Council Resolution 17-312, adopted November 29, 2011.

B. FY08-FY12 OPEB Funding

Pay-as-you-go funding. Table 5 below shows the annual FY08 through FY12 retiree health pay-as-you-go budgets for each of the four County-funded agencies.

Table 5: Annual Retiree Health Pay-As-You-Go Costs by Agency

Agency	FY08	FY09	FY10	FY11	FY12 Budgeted
County Government	\$24.8 million	\$26.0 million	\$26.0 million	\$31.1 million	\$32.5 million
MCPS	\$37.3 million	\$38.4 million	\$37.8 million	\$42.7 million	\$48.1 million
Montgomery College	\$2.5 million	\$2.5 million	\$2.8 million	\$2.7 million	\$3.2 million
M-NCPPC ¹⁵	\$1.2 million	\$2.8 million	\$2.9 million	\$2.5 million	\$2.7 million
Total	\$65.8 million	\$69.7 million	\$69.5 million	\$79.0 million	\$86.4 million

OPEB pre-funding contribution. As shown in Table 6, County agencies began making pre-funding contributions to an OPEB fiduciary trust fund in FY08, did not make any tax supported OPEB pre-funding contributions in FY10 and FY11, and resumed pre-funding in FY12.

Table 6: Annual OPEB Pre-Funding Contributions by Agency

Agency	FY08	FY09	FY10	FY11	FY12 Budgeted ¹⁶
Tax Supported					
County Government	\$12.1 million	\$16.4 million	--	--	\$26.1 million
MCPS	\$16.1 million	\$18.2 million	--	--	\$20.0 million
Montgomery College	\$0.6 million ¹⁷	\$0.7 million	--	--	\$1.0 million
M-NCPPC ¹⁸	\$1.2 million	\$1.9 million	--	--	\$2.7 million
Total Tax Supported	\$30.0 million	\$37.2 million	--	--	\$49.8 million
Total Non-Tax Supported	\$1.9 million	\$3.3 million	\$3.3 million	\$7.3 million	\$12.1 million

The non-tax supported OPEB contributions made in FY10 and FY11 were from the County Government's proprietary funds (e.g., liquor control, permitting services) and from other agencies that participate in the County Government's group insurance programs (e.g., Housing Opportunities Commission, Revenue Authority).

¹⁵ Montgomery County portion only.

¹⁶ In FY12, the County contributed to the Consolidated Retiree Health Trust on behalf of MCPS and Montgomery College.

¹⁷ For several years prior to FY08, the College had set aside funds for accrued retiree health liabilities. By the end of FY07, the College had accumulated over \$20 million for this purpose. These resources were placed by the College into their OPEB Trust Fund in FY08 in addition to the \$600K contribution listed in the table.

¹⁸ Montgomery County portion only, which represents 45% of total plan.

C. Agency OPEB Assumptions

Each agency receives an OPEB valuation on a biennial basis (except for M-NCPPC which receives an annual OPEB valuation) from an independent actuarial consultant. The valuation determines the agency's actuarial accrued liability, current assets, unfunded accrued liability, and annual required contribution. Similar to a pension valuation, an OPEB actuary must make several assumptions. Many assumptions are calculated based on specific data and/or characteristics of an agency's employee population – such as demographics, turnover, retirement eligibility, retirement rates, disability rates, and morbidity.

Certain assumptions are determined by the agencies in consultation with the actuaries. Table 7 below compares three key assumptions (discount rate, healthcare cost trends, and amortization period) by agency.

Table 7. Comparison of Selected Key Assumptions Used by County Agencies in Most Recent Actuarial Valuations

Assumption	County Government	MCPS	Montgomery College	MNCPPC
Discount Rate	6.0% ¹⁹	7.5%	8.0%	7.5% ²⁰
Healthcare Cost Trend	<u>Pre-65 Retirees</u> Initial: 9.5% Ultimate: 5.0% <u>65+ Retirees</u> Initial: 7.5% Ultimate: 5.0%	<u>Pre-65 Retirees</u> Initial: 8.0% Ultimate: 4.5% <u>65+ Retirees</u> Initial: 7.0% Ultimate: 4.5%	<u>All Retirees</u> Initial: 10.5% Ultimate: 5.0%	<u>All Retirees</u> Initial: 9.0% Ultimate: 4.5%
Amortization Period	30-year open period	30-year open period	30-year open period	30-year open period

Discount Rate is a factor used to determine the present value of future OPEB payments and the expected investment rate of return on assets in the trust fund.

Healthcare Cost Trend shows the expected annual rates of increase for agency health care plan costs. Each agency assumes annual healthcare cost increases that start at 8-11% (the “initial” rate) and decrease in future years to 4.5-5% (the “ultimate” rate). Additionally, some agencies adopt different cost trend projections for pre-65 and 65+ (Medicare eligible) retirees.

Amortization Period is the number of years used to spread out the payments for OPEB obligations. County agencies use a 30-year “open” amortization period instead of a closed period. Under a “closed” amortization, the unfunded actuarial liability is amortized, or spread out over a declining period of time. Under an “open” amortization, the amortization period resets each year and the new balance is amortized over another 30 years.

¹⁹ The County Government's plans to incrementally increase the discount rate for OPEB from 6.0% to 7.5% by 2015.

²⁰ MNCPPC uses a select and ultimate discount rate (5.17% in FY12 eventually grading to 7.5%) to develop GASB 45 accrual accounting costs and a flat discount rate of 7.5% to develop the employer cash contributions for OPEB pre-funding.

D. GASB Reporting Requirements

The Governmental Accounting Standards Board (GASB) is an independent not-for-profit organization that establishes accounting and financial reporting standards for state and local governments. In June 2004, GASB issued Statement 45 (GASB 45) regarding government reporting of OPEB obligations. GASB 45 sets standards for governments to report annual OPEB costs as well as the unfunded OPEB liability accrued to date for past employee service.

GASB 45 does not mandate that governments estimate or report retiree health costs that will be earned in the future. Rather, GASB 45 governs reporting of the cost of employee benefits that have already been earned. Additionally, GASB does not have the authority to require governments to pre-fund their OPEB obligations. Nonetheless, auditors assess government financial statements based on GASB standards, and rating agencies commonly use GASB reporting requirements as a factor in rating government-issued bonds (see page 6).

The Council's actuarial consultant, Bolton Partners, reports that GASB soon will consider substantial changes to OPEB accounting and reporting requirements. Bolton advises that new GASB rules likely will modify:

- The method for calculating OPEB liability;
- The standard for amortizing fund gains and losses; and
- The disclosure of a government's OPEB funding policy.²¹

At present, GASB plans to release a draft of the proposed new OPEB requirements (known as an "exposure draft") in mid-2013. GASB intends to issue a statement with revised OPEB requirements by mid-2014.²²

E. Strategies to Decrease Future OPEB Liability

OLO's Part II report on Achieving a Structurally Balanced Budget in Montgomery County (December 10, 2010) included an issue paper that presented options to reduce the projected rate of increase in agency retiree health insurance costs.²³

The primary strategies for decreasing future agency OPEB liability are to: reduce or eliminate retiree group insurance benefits levels; reduce the agency share of benefit costs by shifting a greater share of the costs to retirees; reduce eligibility for retiree health benefits; and, reduce the amount and/or cost of health care used by retirees.

This section provides an overview of the current structure of agency retiree health benefits, and then describes changes made recently by three County agencies recently to their retiree health benefit eligibility and cost sharing structures. In addition, it briefly describes recommendations offered by a Council-appointed Task Force to reduce the long-term cost of health care claims.

²¹ See ©2 for Bolton Partners' full assessment of possible changes in GASB requirements.

²² Government Accounting Standards Board, http://www.gasb.org/cs/ContentServer?site=GASB&c=GASBContentC&pagename=GASB%2FGASBContent_C%2FProjectPage&cid=1176158482340#decisions

²³ <http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/2011-2Part-II.pdf>

1. Components of Retiree Health Benefits

Each County agency determines the group insurance benefits offered to its retirees. Currently, each agency sponsors an array of health plans with varying structures. Key structural components of agency health plans for retirees include:

- **Plan Design and Administration.** Each agency offers multiple health plans for retirees to choose from, and contracts with insurance carriers for plan administration. Based on the design and administrator, each plan has its own structures for variables such as co-pays, deductibles, out-of-pocket maximums, and network of health care providers.
- **Coordination with Medicare.** For all agency retirees, the structure of agency-provided health benefits changes once a retiree becomes eligible for Medicare. Between retirement and age 65, the medical plan offered by each agency is the retiree's primary plan. Once a retiree turns 65, Medicare becomes the primary coverage and the agency plan becomes secondary coverage.
- **Eligibility for Retiree Health Benefits.** Each agency establishes its own eligibility criteria for retiree health benefits. The current criteria are based on different combinations of an employee's years of credited service and/or age.
- **Level of Coverage and Dependents.** Retirees generally choose among three different levels of insurance coverage: self (covers only the employee); self+1 (covers the employee and one eligible dependent); and family (covers the employee and all eligible dependents). MCPS, Montgomery College, and M-NCPPC do not allow the addition of any new dependents once an employee has retired.
- **Cost Share.** Each agency establishes its own criteria for sharing the cost of annual premium amounts between the agency and the enrolled retirees. The current cost share structures vary by agency, and are based on multiple factors such as hire date and years of credited service.

2. Recent Changes to Retiree Health Eligibility

During FY11, the County Government, MCPS, and Montgomery College each made changes to retiree health benefit levels that became effective at the beginning of FY12. The purpose of these changes was to control the rate of growth for OPEB costs. While the specific details of the changes differed, each agency:

- Increased the minimum number of years an employee has to work before becoming eligible for retiree health benefits; and
- Increased the number of years an employee has to work before they can receive the maximum subsidy from the agency.

Montgomery County Government. In June 2011, the County Council approved Resolution No. 17-163 that: raised the minimum years an employee has to work before being eligible for retiree health benefits from five years to ten years; and increased the minimum number of years needed to receive the maximum County subsidy from 15 years to 25 years.

The County Government's health benefits actuarial consultant estimated that the reduction in overall OPEB liability under these specific changes will be 1% in FY13. The percent savings will gradually increase each year as new hires accrue more years of service. Based on the County Government's OPEB annual required contribution (excluding the pay-as-you-go portion), the estimated reduction in liability will be about \$1.2 million in FY13 and progressively higher amounts in future years.²⁴

MCPS. In May 2011, the Board of Education adopted changes to retiree health benefits that: established 10 years as the minimum number an employee needs to work to qualify for retiree health benefits; and increased the minimum number of years need to receive the maximum MCPS subsidy from 5 to 20 years.

MCPS noted the following cost savings associated with this change in the Superintendent's memorandum to the Board of Education requesting approval: "While cost savings will be minor during the first years, estimated at \$276,000 for FY 2012, in the long-term, the cost savings will be significant. Additionally, the Other Post-Employment Benefits (OPEB) liability for retiree health benefits will be decreased by \$12 million and the Annual Required Contribution (ARC) for OPEB would be reduced by \$4.5 to \$5 million for FY 2012."²⁵ For FY13, MCPS plans two changes to retiree prescription drug benefits intended to help manage agency costs: implementing specialty drug management and generic drug step therapy programs.

Montgomery College. In February 2011, the College Board of Trustees adopted Resolution 11-02-013 that: established a minimum age (55) and years of service (15) an employee must have to be eligible for retiree health benefits; increased the minimum number of years needed to receive the maximum College subsidy from 10 years to 20 years; and added a provision that retirees cannot add new dependents after they retire, unless the dependents were previously eligible when the retiree was employed by the College.

The resolution adopted by the Board of Trustees noted that "these alterations will result in future savings and reduction of other post employment benefit (OPEB) liability for Montgomery College."²⁶

3. Task Force Recommendations to Reduce Health Care Utilization

In July 2011, the County Council appointed a Task Force on Employee Wellness and Consolidation of Agency Group Insurance Programs to address two major issues related to the provision of health care benefits to employees and retirees across the agencies: employee wellness and disease prevention programs; and consolidation of plan design and administration.

The Task Force's Final Report concluded that there are several wellness and disease management initiatives that hold the potential to increase the health and well-being of employees, retirees, and their dependents and reduce the cost of health care claims. The Task Force emphasized, however, that "there are no simple solutions to bending the health care cost curve downward. And further, improvements will take time, may require upfront investment, and will likely be incremental."²⁷

The County Council adopted Resolution 17-373 on March 27, 2012 that directed the agencies to take initial steps towards implementing several of the Task Force's recommendations.

²⁴ http://www.montgomerycountymd.gov/content/council/pdf/agenda/cm/2011/110505/20110505_GO1.pdf

²⁵ <http://www.montgomeryschoolsmd.org/boe/meetings/agenda/2010-11/2011-0523/5.1%20Retiree%20health%20benefits.pdf>

²⁶ <http://www.montgomerycollege.edu/explore/mc/bot/2011minpdf/02%20record.pdf>

²⁷ http://www.montgomerycountymd.gov/content/council/wgitt/Report/final_report_111202.pdf

List of Attachments

Document	Begins at:
Standard & Poor's Financial Service Disclaimer	©1
Information on potential OPEB accounting changes prepared by Bolton Partners	©2
Excerpt from Workforce/Compensation Section of County Executive's FY13 Recommended Budget: Consolidated Retiree Health Benefits Trust	©3
County Executive's Recommended FY13-18 Public Service Program: Tax Supported Fiscal Plan Summary	©4

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Montgomery County – Coming OPEB Accounting Changes –

In the summer of 2011 the GASB released an exposure draft of a revised GASB25 pension accounting standard. The GASB is studying similar changes to the GASB45 OPEB accounting standard. OPEB changes are scheduled to be one year behind pension changes. The OPEB exposure draft can be expected to be similar to the Pension exposure draft.

The changes to the OPEB accounting standard are expected to be substantial.

First, the entire unfunded actuarial accrued liability will likely become a liability on the County's statement of net financial position. Under the current standard the only liability on the statement of net financial position is the difference between the expense and the cash amounts actually contributed. *This will cause a substantial decrease in the County's financial position!*

Second, the annual expense will be much more volatile. The current standard allows for up to a 30 year amortization schedule to expense experience gains and losses, the new standard will require that you expense the entire gain or loss attributable to retirees in the year it occurs. For experience gains or losses attributable to employees the new standard requires that the gains and losses be expensed in a much shorter time period about 5-10 years. This means that in years when there is favorable experience the expense may be negative (income) in others when there is adverse experience the expense will be much higher than the current level.

Third, GASB will no longer provide a benchmark to evaluate the contribution effort of the County. Under the current accounting standard the annual expense (the ARC) is a budget based relatively stable amount. Even though many counties do not actually make cash contributions to an OPEB trust at close to the ARC level, it still provides a good yard stick to evaluate a government's funding effort. Because of the volatility of the expense under the standard, governments will have to consider new (non GASB based) yard sticks to determine contributions. The new standard will require that governments disclose their funding policy. That funding policy could be as simple as pay-go costs plus whatever discretionary amounts are available at the end of the year! But how would such a funding policy be viewed by rating agencies?

Finally, the new standard will require a close to real time measurement of assets and liabilities as of the end of the fiscal year *and* there a number of more burdensome disclosure requirements. This will put more pressure on the County staff when preparing the CAFR.

Consolidated Retiree Health Benefits Trust: Beginning in FY08, the County implemented a plan to set aside funds for retiree health benefits, similar to the County's practice of prefunding for retiree pension benefits for more than 50 years. The reasons for doing this are simple: due to exponential growth in expected retiree health costs, the cost of funding these benefits, which are currently paid out as the bills come due, may soon become unaffordable. Setting aside money now and investing it in a Trust Fund, which will be invested in a similar manner as the pension fund, not only is a prudent and responsible approach, but will result in significant savings over the long term.

As a first step in addressing the future costs of retiree health benefits, County agencies developed current estimates of the costs of health benefits for current and future retirees. These estimates, made by actuarial consultants, concluded that the County's total future cost of retiree health benefits if paid out today, and in today's dollars, is \$3.3 billion – approximately three quarters the total FY13 budget for all agencies.

One approach used to address retiree health benefits funding is to determine an amount which, if set aside on an annual basis and actively invested through a trust vehicle, will build up over time and provide sufficient funds to pay future retiree health benefits. This amount, known as an Annual Required Contribution or "ARC", is estimated at \$296.7 million. This amount consists of two pieces – the annual amount the County would usually pay out for health benefits for current retirees (the pay as you go amount), plus the additional amount estimated as needed to fund retirees' future health benefits (the pre-funding portion). The pay as you go amount can be reasonably projected based on known facts about current retirees, and the pre-funding portion is estimated on an actuarial basis.

Proposed FY13 Consolidated Retiree Health Benefits Trust Contributions	
Montgomery County Government (MCG)	FY13
<u>General Fund:</u>	
Retiree Health Benefits Trust NDA	\$43,551,010
<u>Proprietary Funds:</u>	
Bethesda Parking District	\$291,400
Wheaton Parking District	30,140
Silver Spring Parking District	200,960
Solid Waste Collection	50,240
Solid Waste Disposal	753,610
Liquor Control	3,074,750
Permitting Services	1,838,820
Community Use of Public Facilities	271,300
Motor Pool	1,999,590
Risk Management	110,530
Central Duplicating	301,450
<u>Participating Agency Contributions</u>	<u>\$2,483,200</u>
Total MCG Trust Contributions	\$54,957,000
Consolidated Trust: Montgomery County Public Schools	\$61,931,000
Consolidated Trust: Montgomery College	\$1,873,000
Park and Planning Commission Trust Fund¹	\$3,508,900
Total Contributions/Assets Held in Trust	\$122,269,900

¹ MNCPPC's contribution from tax supported funds is \$3,364,500.

The County has committed to an approach of "ramping up" to the ARC amount over several years, with the amount set aside each year increasing steadily until the full ARC is reached. A total of \$31.9 million for all tax supported agencies was budgeted for this purpose in FY08. In May 2008, the County Council passed resolution No. 16-555 which confirmed an eight-year phase-in approach to the ARC. Consistent with this approach and based on the County's economic situation, the County contributed \$14.0 million to the Trust in FY08, \$19.7 million in FY09, \$3.3 million in FY10, and \$7.3 million in FY11. Due to fiscal constraints, the County did not budget a contribution for the General Fund in FY10 and FY11, but did resume contributions in FY12. For FY12, the County contributed \$26.1 million from the General Fund to the Retiree Health Benefits Trust. In addition, on

June 26, 2011, the County Council enacted Bill 17-11 which established the Consolidated Retiree Health Benefits Trust. The bill amended existing law and provided a funding mechanism to pay for other post employment benefits for employees of Montgomery County Public Schools and Montgomery County College. In FY12, the County appropriated \$20 million and \$1 million for contributions on behalf of MCPS and the College, respectively. A detailed breakdown of FY13 recommended contributions to the Consolidated Retiree Health Benefit Trust for County Government tax supported agencies, participating agencies, Montgomery County Public Schools, and Montgomery College is displayed in the table above. The Council and the Executive have mutually committed to the County's rating agencies to achieve full pre-funding by FY15.

Retirement Plans:

Montgomery County government maintains three retirement plans for its employees: a defined benefit pension plan, a defined contribution plan, and a deferred compensation plan for its employees and participating agencies.

County Executive's Recommended FY13-18 Public Services Program

Tax Supported Fiscal Plan Summary

(\$ in Millions)														
	App. FY12	Estimate FY12	% Chg. FY12-13	Projected FY13	% Chg. FY13-14	Projected FY14	% Chg. FY14-15	Projected FY15	% Chg. FY15-16	Projected FY16	% Chg. FY16-17	Projected FY17	% Chg. FY17-18	Projected FY18
Total Revenues	5-26-11		Rec/Bud	3-15-12										
1 Property Tax (less PDs)	1,462.2	1,437.0	0.0%	1,462.2	3.0%	1,505.8	3.1%	1,553.2	3.5%	1,608.2	3.5%	1,664.5	3.1%	1,715.4
2 Income Tax	1,117.2	1,227.1	11.2%	1,242.9	2.9%	1,278.9	6.7%	1,364.4	4.7%	1,428.8	3.6%	1,480.0	4.2%	1,541.5
3 Transfer/Recordation Tax	143.5	123.9	-9.5%	129.9	8.1%	140.5	5.6%	148.4	7.4%	159.4	7.4%	171.2	5.6%	180.8
4 Investment Income	1.6	0.2	-70.3%	0.5	33.6%	0.6	94.0%	1.2	134.2%	2.9	55.8%	4.5	26.3%	5.7
5 Other Taxes	325.3	311.6	-3.0%	315.5	1.4%	320.1	2.3%	327.3	1.8%	333.1	1.1%	336.7	0.8%	339.6
6 Other Revenues	842.2	838.9	4.0%	876.2	0.5%	880.3	0.5%	884.3	0.4%	888.3	0.5%	892.3	0.5%	896.4
7 Total Revenues	3,892.1	3,938.7	3.5%	4,027.2	2.5%	4,126.1	3.7%	4,278.8	3.3%	4,420.7	2.9%	4,549.2	2.9%	4,679.3
8														
9 Net Transfers In (Out)	41.3	35.9	-27.6%	29.9	2.9%	30.7	2.8%	31.6	2.6%	32.5	2.7%	33.3	2.7%	34.2
10 Total Revenues and Transfers Available	3,933.4	3,974.6	3.1%	4,057.1	2.5%	4,156.9	3.7%	4,310.5	3.3%	4,453.1	2.9%	4,582.5	2.9%	4,713.5
11														
12 Non-Operating Budget Use of Revenues														
13 Debt Service	296.2	279.0	2.5%	303.5	6.8%	324.3	9.6%	355.3	5.4%	374.6	4.1%	389.8	0.0%	389.8
14 PAYGO	31.0	31.0	-4.8%	29.5	0.0%	29.5	0.0%	29.5	0.0%	29.5	0.0%	29.5	0.0%	29.5
15 CIP Current Revenue	35.0	35.0	52.8%	53.5	51.4%	81.0	-26.5%	59.5	-2.7%	58.0	-1.8%	56.9	16.2%	66.1
16 Change in Montgomery College Reserves	(9.0)	(4.0)	46.4%	(4.8)	102.3%	0.1	1.4%	0.1	-4.6%	0.1	2.1%	0.1	2.1%	0.1
17 Change in MNCPPC Reserves	(1.5)	(2.5)	37.1%	(1.0)	99.9%	(0.0)	9543.7%	0.1	14.1%	0.1	0.4%	0.1	35.5%	0.2
18 Change in MCPS Reserves	(17.0)	7.4	0.0%	(17.0)	22.1%	(13.3)	100.0%	0.0	n/a	0.0	n/a	0.0	n/a	0.0
19 Change in MCG Special Fund Reserves	22.8	1.4	-24.3%	17.3	-100.0%	0.0	532.7%	0.0	18.5%	0.0	-9.7%	0.0	-10.8%	0.0
20 Contribution to General Fund Undesignated Reserves	66.4	90.6	-122.8%	(15.1)	106.1%	0.9	527.6%	5.8	18.5%	6.8	-9.7%	6.2	-10.8%	5.5
21 Contribution to Revenue Stabilization Reserves	20.4	45.1	3.0%	21.0	3.3%	21.7	4.1%	22.6	3.7%	23.5	3.6%	24.3	3.1%	25.1
22 Retiree Health Insurance Pre-Funding	49.6	49.6	123.1%	110.7	28.9%	142.8	20.4%	171.9	0.0%	171.9	0.0%	171.9	0.0%	171.9
23 Set Aside for other uses (supplemental appropriations)	0.2	10.2	-67.2%	0.1	30441.4%	20.1	0.0%	20.1	0.0%	20.1	0.0%	20.1	0.0%	20.1
24 Total Other Uses of Resources	494.3	542.9	0.7%	497.8	22.0%	607.2	9.5%	665.0	2.9%	684.6	2.1%	698.9	1.3%	708.3
25 Available to Allocate to Agencies (Total Revenues+Net Transfers-Total Other Uses)	3,439.1	3,431.7	3.5%	3,559.3	-0.3%	3,549.7	2.7%	3,645.5	3.4%	3,768.6	3.1%	3,883.6	3.1%	4,005.2
26														
27 Agency Uses														
28														
29 Montgomery County Public Schools (MCPS)	1,950.9	1,926.8	2.6%	2,001.6	-0.3%	1,996.2	2.7%	2,050.1	3.4%	2,119.3	3.1%	2,184.0	3.1%	2,252.4
30 Montgomery College (MC)	218.0	214.6	0.2%	218.4	-0.3%	217.8	2.7%	223.7	3.4%	231.2	3.1%	238.3	3.1%	245.7
31 MNCPPC (w/o Debt Service)	94.3	94.3	4.7%	98.8	-0.3%	98.6	2.7%	101.2	3.4%	104.6	3.1%	107.8	3.1%	111.2
32 MCG	1,175.8	1,196.0	5.5%	1,240.5	-0.3%	1,237.1	2.7%	1,270.5	3.4%	1,313.4	3.1%	1,353.5	3.1%	1,395.9
33 Agency Uses	3,439.1	3,431.7	3.5%	3,559.3	-0.3%	3,549.7	2.7%	3,645.5	3.4%	3,768.6	3.1%	3,883.6	3.1%	4,005.2
34 Total Uses	3,933.4	3,974.6	3.1%	4,057.1	2.5%	4,156.9	3.7%	4,310.5	3.3%	4,453.1	2.9%	4,582.5	2.9%	4,713.5
35 (Gap)/Available	0.0	0.0		0.0		0.0		0.0		0.0		0.0		0.0

Assumptions:

1. Property tax revenue is \$26 million below the Charter Limit and kept the same as the FY12 approved budget. Assumes \$692 income tax offset credit.
2. May 2010 Energy Tax increase is retained.
3. Reserve contributions at the policy level and consistent with legal requirements.
4. PAYGO, Debt Service, and Current Revenue updated to reflect the FY13 recommended CIP and current revenue amendments.
5. Retiree health insurance pre-funding is increased up to full funding by FY15, and then kept level beyond FY15. FY13 is year 6 of 8-year funding schedule.

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County Executive's Recommended FY13-18 Public Services Program

Tax Supported Fiscal Plan Summary

(\$ in Millions)

	App. FY12	Est FY12	% Chg. FY12-13	Projected FY13	% Chg. FY13-14	Projected FY14	% Chg. FY14-15	Projected FY15	% Chg. FY15-16	Projected FY16	% Chg. FY16-17	Projected FY17	% Chg. FY17-18	Projected FY18
Beginning Reserves														
Unrestricted General Fund	66.9	64.0	131.2%	154.7	-9.8%	139.5	0.7%	140.4	4.1%	146.2	4.7%	153.0	4.0%	159.1
Revenue Stabilization Fund	94.5	94.5	47.7%	139.6	15.1%	160.6	13.5%	182.4	12.4%	205.0	11.5%	228.5	10.6%	252.9
Total Reserves	161.4	158.6	82.3%	294.2	2.0%	300.2	7.6%	322.8	8.8%	351.2	8.6%	381.5	8.0%	412.0
Additions to Reserves														
Unrestricted General Fund	66.4	90.6	-122.8%	-15.1	106.1%	0.9	527.6%	5.8	18.5%	6.8	-9.7%	6.2	-10.8%	5.5
Revenue Stabilization Fund	20.0	45.1	5.4%	21.0	3.3%	21.7	4.1%	22.6	3.7%	23.5	3.6%	24.3	3.1%	25.1
Total Change in Reserves	86.4	135.7	-93.2%	5.9	283.5%	22.7	25.3%	28.4	6.7%	30.3	0.6%	30.5	0.3%	30.6
Ending Reserves														
Unrestricted General Fund	133.3	154.7	4.6%	139.5	0.7%	140.4	4.1%	146.2	4.7%	153.0	4.0%	159.1	3.4%	164.6
Revenue Stabilization Fund	114.5	139.6	40.3%	160.6	13.5%	182.4	12.4%	205.0	11.5%	228.5	10.6%	252.9	9.9%	278.0
Total Reserves	247.8	294.2	21.1%	300.2	7.6%	322.8	8.8%	351.2	8.6%	381.5	8.0%	412.0	7.4%	442.6
Reserves as a % of Adjusted Governmental Revenues	6.1%	7.2%		7.1%		7.4%		7.8%		8.2%		8.7%		9.1%
Other Reserves														
Montgomery College	7.0	11.2	-7.6%	6.4	1.7%	6.5	1.7%	6.6	1.6%	6.7	1.6%	6.9	1.6%	7.0
M-NCPPC	3.7	4.8	3.3%	3.9	0.0%	3.9	3.2%	4.0	3.6%	4.1	3.5%	4.3	4.5%	4.5
MCPS	0.0	30.3	n/a	13.3	-100.0%	0.0	n/a	0.0	n/a	0.0	n/a	0.0	n/a	0.0
MCG Special Funds	2.6	(16.5)	-67.6%	0.8	0.7%	0.8	4.1%	0.9	4.7%	0.9	4.0%	0.9	3.4%	1.0
MCG + Agency Reserves as a % of Adjusted Govt Revenues	6.5%	7.9%		7.7%		7.7%		8.1%		8.5%		8.9%		9.3%
Retiree Health Insurance Pre-Funding														
Montgomery County Public Schools (MCPS)	20.0	20.0		61.9		80.3		101.6		100.9		99.7		99.7
Montgomery College (MC)	1.0	1.0		1.9		2.4		3.1		3.0		2.8		2.8
MNCPPC	2.6	2.6		3.4		6.3		7.7		7.4		7.2		7.2
MCG	26.1	26.1		43.6		53.8		59.5		60.6		62.2		62.2
Subtotal Retiree Health Insurance Pre-Funding	49.6	49.6		110.7		142.8		171.9		171.9		171.9		171.9
Adjusted Governmental Revenues														
Total Tax Supported Revenues	3,892.1	3,938.7	3.5%	4,027.2	2.5%	4,126.1	3.7%	4,278.8	3.3%	4,420.7	2.9%	4,549.2	2.9%	4,679.3
Capital Projects Fund	45.6	60.3	43.7%	65.5	52.1%	99.6	2.3%	101.9	-11.8%	89.9	1.1%	90.8	-11.0%	80.8
Grants	108.9	108.9	-1.7%	107.0	2.9%	110.1	2.9%	113.3	2.7%	116.3	2.7%	119.4	2.7%	122.6
Total Adjusted Governmental Revenues	4,046.6	4,108.0	3.8%	4,199.7	3.2%	4,335.9	3.6%	4,494.0	3.0%	4,626.8	2.9%	4,759.4	2.6%	4,882.7

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